

The Public Policy Exception to the New York Convention on the Recognition and Enforcement of Arbitral Awards

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Arguments are as much a part of life as are agreements. Today's businessmen, like the traders of yesterday, know that commercial disagreements require fast, efficient, and effective settlement. While we may think of the courts as the primary mechanism for solving disputes, most disagreements are resolved informally while increasing numbers are being solved through formal, but alternative methods.¹ Arbitration is one such method.

Arbitration is the submission of a disagreement to an impartial arbitrator (or arbitration panel) with the understanding that the parties will abide by the arbitrator's decision.² Although arbitration among parties certainly has elements of the judicial process, it is an alternative that co-exists with the court system, without purporting to replace it.³

Arbitration has been used since the days of early traders and the days of Greek city states.⁴ Professor Darby lists 540 cases submitted to arbitral procedures after 1794.⁵ Arbitration was employed

1. R. COULSON, BUSINESS ARBITRATION — WHAT YOU NEED TO KNOW 5 (2d ed. 1982).

2. See generally *id.* at 5.

3. DOMKE COMM ARBITRATION § 1:01 (Rev. Ed).

Unfortunately, arbitration was not always viewed in this light. At common law, arbitration was historically viewed with disfavor. The origin of this attitude is commonly traced to the dictum of Lord Coke in *Vynior's Case*, 8 Coke Rep. 81b, 77 Eng. Rep. 597 (K.B. 1069). The English courts held that individuals may not contract to "oust" the courts of jurisdiction. *Kill v. Hollister*, 1 Wilson 129, 95 Eng. Rep. 532 (K.B. 1746). Peter Sonderby in his article, *Commercial Arbitration: Enforcement of an Agreement to Arbitrate Future Disputes*, 5 J. MAR. J. PRAC. & PROC. 72 (1971), notes that this concept of "ouster" was adopted at an early stage in the United States. The historical development of this concept and its abolition in America is well described in *Kulukundis Shipping Co. v. Amtorg Trading Co.*, 126 F.2d 978, 985 (2d Cir. 1942), where the court felt an "obligation to shake off the old judicial hostility to arbitration." For a history of arbitration in the United States, see F. KELLOR, AMERICAN ARBITRATION: ITS HISTORY, FUNCTIONS AND ACHIEVEMENTS (1948).

4. Gertrude Smith, *The Greeks had a word for it—25 Centuries Ago*, Arbitration Magazine, Vol. I, Nos.4-5 (1943), p.5.

5. W. EVANS DARBY, INTERNATIONAL TRIBUNALS 769 (1904). (Although these were arbitrations among nation-states the underlying claim was often of a commercial nature.) See also J.H. RALSTON, INTERNATIONAL ARBITRATION FROM ATHENS TO LOCARNO 345 (1929).

not only in Europe at this time, but also in the United States, Latin America, Asia, Africa, and the Middle East.⁶ Although many of these settlements may not have been arbitration in the full sense of the term today, Darby's list indicates the "tremendous prestige of international arbitration in the 19th Century."⁷ Today, private commercial arbitration improves the climate of international trade by providing the forums essential to efficient disposal of disputes between business parties of different nations.

In order for international arbitration to be effective, however, the parties must be able to enforce arbitral awards.⁸ Treaties have been enacted to guarantee the international respect necessary for the domestic courts of various nations to enforce private foreign arbitral awards.

Not surprisingly, these international agreements contain certain exceptions under which the courts may legally refuse to enforce a foreign arbitral award. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards,⁹ commonly known as the New York Convention of 1958 (hereinafter referred to as the New York Convention), currently governs the recognition and enforcement within the United States of foreign arbitration awards obtained outside the United States. This treaty contains a public policy exception which permits domestic courts to refuse enforcement of a foreign arbitration award if the award violates the public policy of the nation in which enforcement is sought. Unfortunately, a broad interpretation of the public policy defense undermines the strength and effectiveness of the New York Convention, and in turn, casts doubts on the effectiveness of international arbitration. This Note first discusses the value and history of international arbitration, then explores the New York Convention's public policy exception to the enforcement of foreign arbitral awards, and finally, offers an approach for the application of the public policy exception in a manner that does not threaten international trade or public policy.

6. For a history of Arbitration in the United States, see F. KELLOR, *AMERICAN ARBITRATION: ITS HISTORY, FUNCTIONS AND ACHIEVEMENTS* (1948).

7. Wright, *Arbitration As a Symbol of Internationalism*, in *INTERNATIONAL TRADE ARBITRATION* 4 (M. Domke ed. 1958).

8. The extent to which nation-states are bound by arbitration has always been controversial. John Basset Moore classified international arbitration between states as a judicial procedure. Moore, *Digest Vol. 7*, at 24. Elihu Root, however, thought arbitration between nation-states to be largely a political procedure. Hackworth, *Digest Vol. 6*, at 61.

9. 330 U.N.T.S. 38 (1959); 21 U.S.T. 2517, T.I.A.S. No. 6997 (1970) [hereinafter cited as New York Convention].

I. ARBITRATION IN THE INTERNATIONAL ARENA

A. *The Value of Arbitration*

The value of arbitration in international business stems from its many advantages over judicial resolution of disagreements. Surveys taken by the American Arbitration Association indicate that arbitration is often preferred because business interests prefer to have their disputes settled by someone with expertise in the field of the dispute.¹⁰ Since arbitration clauses can specify who the arbitrator shall be, an agreed upon individual with expertise and experience in the area of the dispute can be appointed.¹¹ This eliminates the possibility of the legal system of a country unfairly favoring its own citizen. The speed and simplicity of arbitration is an attractive inducement when businesses do not want to have their capital and stock tied up in a long court proceeding, especially when market rates are fluctuating rapidly. The complexity of international litigation lacks the certainty and predictability that businesses desire. Additionally, arbitration preserves confidentiality which contributes to the continuance of long term business relationships since trade secrets are not released and reputations are not damaged as in open trials and reported court decisions. Arbitral awards are not subject to judicial review or appeal. This serves the international business community's interest in conclusive results. Arbitration also avoids the pragmatic problems of language differences, service of process, and finding legal representation qualified to practice in a foreign court.¹² In sum, the use of arbitration increases the security of international transactions and thus eases the barriers to international trade.¹³

The demand for international arbitration has resulted in the development of hundreds of arbitration agencies that now offer services for dispute resolution between citizens of different countries.¹⁴ Some of the most popular and well known include the American

10. R. COULSON, *BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW* 7 (2d ed. 1982).

11. *Id.*

12. Aksen, *The Need to Utilize International Arbitration*, 17 VAND. J. TRANSNAT'L L. 11 (1984).

13. For further benefits of arbitration such as increase in trade, investment, free world security, human freedom, and justice, see generally Gardner, *Economic and Political Implications of International Commercial Arbitration* in INTERNATIONAL TRADE ARBITRATION (M. Domke ed. 1958).

14. Aksen, *American Arbitration Accession Arrives In the Age of Aquarius: United States Implements United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 3 SW. U. L. REV. 1, 3 (1971).

Arbitration Association, the International Chamber of Commerce, and the London Court of Arbitration.¹⁵ The parties may designate the forum, procedures, and rules of law or equity to be used. The assurance of these conditions agreed to beforehand establishes reliable principles and procedures controlling the resolution of any dispute, and therefore aids the parties in understanding and performing their duties under the contract.

B. *The Historical Framework of Arbitration*

Arbitration has long been accepted in the United States. As early as 1855 the United States Supreme Court stated that "As a mode of settling disputes, it [arbitration] should receive every encouragement from courts of equity."¹⁶ Both state and federal legislation have generally reflected this common law acceptance of arbitration.¹⁷ The federal legislation concerning arbitration is primarily contained in the Federal Arbitration Act which was first enacted in 1925 and has been amended several times since.¹⁸ The most recent amendment was made in 1970 in order to implement the accession by the United States to the New York Convention.

The New York Convention of 1958 was built upon the ground work established by the Geneva Protocol of 1923 on Arbitration Clauses,¹⁹ the Geneva Convention of 1927 on the Execution of Foreign Arbitral Awards,²⁰ and a result of a request in 1953 by the International Chamber of Commerce to the United Nations Economic and Social Council to convene on the subject of enforcement of international arbitration judgments.²¹ The New York Convention was also precipitated by the increased demand for commercial arbitration by international businesses trying to achieve the advantages of arbitration.²²

15. The workings of these and other arbitral institutions are well described in *HANDBOOK OF INSTITUTIONAL ARBITRATION IN INTERNATIONAL TRADE* (E. Cohn, M. Domke, F. Eisenman ed. 1977).

16. *Burchell v. Marsh*, 58 U.S. 344, 349 (1855).

17. HOLTZMANN, *United States*, *INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION* 1 (1984).

18. *Id.*

19. Geneva Protocol on Arbitration Clauses, Sept. 24, 1923, 27 L.N.T.S. 157.

20. Geneva Convention on the Execution of Foreign Arbitral Awards, Sept. 26, 1927, 92 L.N.T.S. 301.

21. Quigley, *Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 *YALE L. J.* 1049, 1059 (1961).

22. See generally Aksén, *supra* note 14.

The United States was a participant when the New York Convention was negotiated in 1958. However, on the basis of the U.S. delegation's recommendation against acceptance of the Convention, the United States did not sign despite the Convention's acceptance by ten countries immediately and thirteen more within the immediate ratification period.²³ The delegation's negative recommendation stemmed from the judgment that acceptance of the Convention would not be advantageous to the United States, and that it would conflict with United States procedures and principles of law at that time.²⁴ Interested private individuals²⁵ and groups²⁶ expressed support for the Convention, however, and in 1968 the President submitted the Convention to the Senate for its advice and consent.²⁷

The use of arbitration had developed substantially in the United States at that time, and an increasing number of bilateral United States treaties had begun to include arbitration provisions. This development of the legal infrastructure since 1958 also set the stage for acceptance.²⁸ The Senate approved the Convention and Congress passed implementing legislation in 1970.²⁹ The New York Convention became effective in the United States on December 29, 1970.³⁰ The Convention has now been accepted by sixty-five States.³¹ The advantages of the new Convention over its predecessors were outlined at the close of the meetings by Mr. Schurmann, the President of the Conference. In his view,

... it was already apparent that the document represented an improvement on the Geneva Convention of 1927. It gave a wider definition of the awards to which the convention applied; it reduced and simplified the requirements with which the party seeking recognition or enforcement of an award would have to comply; it placed the burden of proof on the

23. Quigley, *supra* note 21, at 1060.

24. McMahon, *Implementation of the United Nations Convention on Foreign Arbitral Awards in the United States*, 2 J. MAR. L. & COM. 735, 737 (1971).

25. See generally Quigley, *supra* note 21.

26. Springer, *The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 3 INT'L L. 320, 321 (1969).

27. Message from the President, *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, S. EXEC. DOC. E. 90th Cong., 2d Sess. at 1, 3-5, 27-44 (1968).

28. For a history of the development of the legal infrastructure that permitted the acceptance of the New York convention, see Aksen, *supra* note 14, at 4.

29. Act of July 31, 1970, Pub. L. No. 91-368, 84 Stat. 692, 9 U.S.C. 201 (1970).

30. Note, *United Nations Foreign Arbitral Awards Convention: United States Accession*, 2 CAL. W. INT'L L. J. 67 (1971).

31. *International Commercial Arbitration: New York Convention*, part VI.1 (G. Gaja ed. 1984).

party against whom recognition or enforcement was invoked; it gave the parties greater freedom in the choice of the arbitral authority and of the arbitration procedure; it gave the authority before which the award was sought to be relied upon the right to order the party opposing the enforcement to give suitable security.³²

II. THE PUBLIC POLICY DEFENSE

A. *An Overview of the New York Convention*

Despite the advantages of arbitration, it is valuable only to the extent that the agreement to arbitrate and the resulting award can be enforced against a recalcitrant party. Since parties to international arbitration agreements and disputes are often individuals or corporations of different countries, one of the parties may have to rely on the court of another nation to enforce an arbitral award that was issued in yet a third nation. Absent some international agreement to recognize and enforce such an award, international law does not impose any such obligation.³³ The New York Convention now imposes such an obligation on its signatories.

The principal features and obligations of the New York Convention are set forth in Articles I through VI. Article I establishes the limitations of the treaty's scope. The treaty applies only to foreign (international) commercial agreements to arbitrate. Article I also permits States to limit their obligation to enforce only awards made in reciprocating nations. Article II provides that the arbitration clause must be in writing, and requires the subject matter to be capable of arbitration.³⁴ Article III requires each contracting State to recognize and enforce arbitral awards fairly. Article IV provides that a party may obtain recognition and enforcement of an arbitral award by merely supplying a certified copy of the contract containing the agreement to arbitrate and a certified copy of the arbitrator's award. Article V(1) details the allowable defenses that may be raised by the parties to the recognition and enforcement of the award, while Article V(2) states the grounds on which the court itself may

32. U.N. Doc. E/CONF. 26/SR.25, p.2 (1958).

33. *But see* Sultan, *The United Nations Arbitration Convention and United States Policy*, 53 AM. J. INT'L L. 807, 816, 817 (1959), which argues that reciprocity and comity bind nations to enforce arbitration awards.

34. It has been argued that an arbitral award that cannot be enforced because of public policy is also a matter that is not capable of arbitration. The overlap between Article V(2)(a) and Article II has been well noted elsewhere and is not covered in this paper. *See generally* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., 723 F.2d 155, 164 (1st Cir. 1983); Quigley, *supra* note 21, at 1064; Aksent, *supra* note 13, at 8; McMahon, *supra* note 24, at 753.

ex officio deny enforcement. Article VI permits the court either to accept an Article V reason to deny enforcement of the award or to accept the argument of the party seeking enforcement of the award and require security on the award from the opposing party.³⁵

In practical terms, a party seeking enforcement of an arbitral award against a party in the United States would simply mail a copy of both the original contract and the arbitrator's decision to the U.S. federal district court having jurisdiction over the opposing party. The court then enters judgment on the award. If the judgment upholds the award, the prevailing party may use all legal means to execute the judgment.

Despite what would logically appear to be a strong interest in the promotion of international conventions and uniform rules to enforce arbitration agreements and thus to increase the certainty of international trade agreements, the United States has lagged in its response to developments in this area.³⁶ Indeed, while the New York Convention marks the first time the United States has acceded to a multilateral treaty on the subject,³⁷ even here the accession came twelve years after initially rejecting the Convention as unfavorable to the United States.³⁸ The accomplishment of the New York Convention, however, is marred by the public policy exception of Article V. Article V permits the courts to refuse to recognize or enforce an award if the appropriate court of that nation finds that such recognition or enforcement of the award would be contrary to the public policy of that country.³⁹

35. Article VII states that the Convention shall not affect the validity of other agreements entered into by the contracting States, except that The Geneva Protocol on Arbitration Clauses of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927 shall cease to have effect on contracting States. Articles VIII, IX, and X address the procedure of accession to the Convention. Article XI details the applicability of the Convention to a federal or non-unitary State. Articles XII and XIII specify when the Convention comes into force or may be terminated in regard to specific States. Article XIV limits the use of the Convention by a contracting State against other contracting States to the extent the first State is bound by the Convention. Article XV stipulates for the Secretary-General of the United Nations to notify the contracting States of the status of the other contracting States. Finally, Article XVI states that the Chinese, English, French, Russian, and Spanish texts of the Convention are all equally authentic, and that the Secretary-General of the United Nations shall transmit a certified copy of the Convention to the contracting States.

36. McMahon, *supra* note 24, at 736.

37. U.S./U.N. press release 126 dated Sept. 30, 1970, in DEPT STATE BULL., Nov. 9, 1970 at 598.

38. See McMahon, *supra* note 24.

39. New York Convention Article V(2)(b).

The refusal to enforce an arbitral award goes right to the heart of the Convention. Article V sums up the grounds for the refusal of recognition and enforcement. Article V(1)(a) through (e) points out the arguments the court may accept from the parties to refuse the award.⁴⁰ Article V(2) deals with the two grounds of public policy that the court of its own accord may invoke to refuse an award. Article V(2)(a) states that recognition may be refused if the dispute is not capable of settlement by arbitration under the laws of that country. Both commentators and courts have seen this provision as parallel to Article II or subsumed by the term "public policy."⁴¹ Article V(2)(b) deals with the public policy issue directly when it

40. These include:

- 1) The parties to the agreement are under some "incapacity."
- 2) The arbitration agreement is not valid under the law to which the parties have subjected it, or under the law of the country where the award was made.
- 3) There is no "proper notice" given to the party against whom the award is to be enforced. Although no standards for judging the propriety of the notice or the adequacy of opportunity to be heard are specified, Americans are so imbued with the concept of "due process," that it is unlikely that our courts will have any difficulty in construing these terms.
- 4) The party against whom enforcement of the award is sought is "otherwise unable to present his case." It is important to note that this section does not provide for refusal of an award on the grounds that it was rendered "ex parte." It seems clear, therefore, that arbitrators would be able to render awards upon the default of a party who was duly notified of the appointment of the arbitrator, but merely elected not to appear at the proceedings.
- 5) If the matter decided, or an inseparable part of it goes beyond the scope of the agreement to arbitrate. This is undoubtedly similar to the provisions in modern American arbitration statutes that provide an award may be set aside when the arbitrator exceeds his power under the agreement.
- 6) The composition of the arbitral authority or the arbitral procedure is not in accordance with the parties' agreement, or if not specified, the agreement is not in accordance with the law of the country in which the arbitration takes place. It is apparent that the parties have complete autonomy in the selection of the arbitral procedure, providing it is not illegal "under the law to which the parties have subjected it" as per Article V. para. 1(a).
- 7) The award has not yet become "binding" on the parties or has been set aside or suspended by a competent authority of the country in which, or under the law of which, the award was made.

Aksen, *supra* note 14 at 11, 12.

A discussion of other arguments, and how they are distinguished from the public policy argument, can also be found in Note, *The Public Policy Defense to Recognition and Enforcement of Foreign Arbitral Awards*, 7 CAL. W. INT'L L.J. 228, 231 (1977).

41. See note 34 *supra*.

states that recognition and enforcement of an arbitral award may be refused if it would be "contrary to the public policy of that country." This public policy defense to the enforcement of foreign arbitral awards has been considered the greatest single threat to the use of arbitration in commercial disputes.⁴² Courts and commentators alike have worried that the expansion of this loophole could negate the effectiveness of the Convention.⁴³ Yet, it appears that while the defense is often raised, it is rarely successful.⁴⁴

B. Legislative History of the New York Convention

When a United States federal court is presented with a question regarding the scope of the public policy defense in the New York Convention, ostensibly that court would turn toward generally accepted methods of treaty interpretation such as, *inter alia*, referring to the negotiating history of the Convention.⁴⁵ Unfortunately, the history of the Convention in regard to the public policy exception is sparse.

The United Nations committee that prepared the draft convention indicated in its report to the U.N. Conference its intent to limit the application of the public policy exception "[T]o cases in which the recognition or enforcement of a foreign arbitral award would be distinctly contrary to the basic principles of the legal system of the country where the award is invoked."⁴⁶

The Secretary General considered the comments submitted by governments, organizations, and others before simplifying this to read: "If the arbitral award would have the effect of compelling the parties to act in a manner contrary to public policy in the country of enforcement."⁴⁷ While discussion on the definition of

42. Note, *The Public Policy Defense to Recognition and Enforcement of Foreign Arbitral Awards*, 7 CAL. W. INT'L L.J. 228 (1977).

43. See generally *Parsons & Whittmore Overseas Co. v. Societe Generale De L'Industrie Du Papier [RAKTA]*, 508 F.2d 969 (2d Cir. 1974); G. Haight, CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN AWARDS—SUMMARY ANALYSIS OF RECORD OF UNITED NATIONS CONFERENCE MAY/JUNE 67 (1958).

44. Sanders, *A Twenty Years' Review of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 13 INT'L LAW. 269, 270 (1979).

45. "[W]hen the meaning of a treaty is not clear, recourse may be had to the negotiations, preparatory works, and diplomatic correspondence . . ." *Arizona v. California*, 292 U.S. 341, 359-60 (1934). See also *Block v. Compagnie Nationale Air France*, 386 F.2d 323, 336-37 (5th Cir. 1967), cert. denied, 392 U.S. 905 (1968).

46. U.N. ESCOR, Report of the Committee on the Enforcement of International Arbitral Awards §49, U.N. Doc. E/2704 and Corr. 1, E/AC.42/4/Rev. 1 (1955).

47. Haight, *supra* note 43, at 67.

public policy, or *ordre public*,⁴⁸ presented varied national positions, the final draft clearly seemed to reflect an intention to narrow the possible use of public policy.⁴⁹ Some commentators felt that the effect of the exception was to create an "escape clause" that was necessary for ratification of the Convention by the United States.⁵⁰

This escape clause, however, may not be as flexible in the hands of United States courts as some commentators may like to believe. The domestic court is obliged to interpret the treaty in a manner consistent with the international norm to prevent claims of a United States violation of the treaty. Such a violation, if presented to an international tribunal,⁵¹ is not necessarily determined by United States domestic legal standards, but rather by the standards of international law.⁵²

Still, courts may be tempted to turn toward domestic standards of public policy for guidelines. State and federal courts have refused to enforce domestic arbitration agreements on the basis of public policy.⁵³ Unfortunately, the exact scope of the public policy defense against domestic arbitration is also a matter of flux and litigation.⁵⁴ However, even if domestic public policy standards are clarified, Professor Sanders points out the mistake in relying on domestic public policy standards in international disputes. He discusses the distinction that the courts draw between the public policy test in purely national affairs and the public policy test to be applied in international agreements.⁵⁵ "In respect to the latter [international

48. *Ordre public* is the term used in the French text to translate "public policy." The French text is as equally authentic as the English text. New York Convention Article XVII(1).

49. The Chairman of the Working Party said that "as regards to paragraph 2(b) of Article IV, the Working Party felt that the provision allowing refusal of enforcement on grounds of public policy should not be given a broad scope of application." Haight, *supra* note 43, at 67. (Article IV was changed to Article V in a later draft.)

50. Barry, *Application of the Public Policy Exception to the Enforcement of Foreign Arbitral Awards Under the New York Convention: A Modest Proposal*, 51 TEMPLE L. Q. 832, 839 (1978).

51. Such as the International Court of Justice.

52. "But should the public law of one of the Parties seem contrary to international public policy ('Ordre Public International'), an International Tribunal is not bound by the municipal law of the States which are Parties to the arbitration." Norwegian Shipowners' Claim (Norway v. U.S.A). 1 R. INT'L ARB. AWARDS 307, 330 (1922). See also Lipstein, *Conflict of Laws Before International Tribunals*, 27 GROTIUS SOC'Y 142, 156-57 (1942).

53. Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481, (1981).

54. *Id.*

55. Sanders, *supra* note 44, at 270.

agreements], the narrower criterion of violation of the international public order is applied."⁵⁶

Varying linguistic interpretations present another question of interpretation concerning the public policy defense. The French text of the Convention, which is considered equally authentic, uses the term "ordre public," which may have a different meaning.⁵⁷ Some indication as to the proper interpretation of the term "public policy" can be seen from the effort of the Convention's framers in trying to narrow the use of the public policy exception from the exception's use in previous multilateral arbitration agreements.⁵⁸ In treaties at recent Hague Conferences, the drafters had made special note when their intention was to use the broader interpretation of *ordre public*.⁵⁹ The simple use of *ordre public* in the French text of the New York Convention, suggests that a narrow construction should be given "public policy" because no special notation was made.

Although it appears "the Conference wanted to limit the scope of the public policy exception as far as possible,"⁶⁰ the American delegate pragmatically pointed out, "Certainly 'public policy' will provide considerable scope for the ingenuity of defense counsel and it is quite likely that a variety of interpretations will be forthcoming from courts of different nations."⁶¹

C. Common Law Development of the New York Convention

An examination of the past treatment of the public policy exception by American courts in international agreements controlled by the Convention illustrates the acceptable uses of the exception as well as establishing controlling precedent. In 1979, of 100 cases applying the Convention, enforcement has been refused for reasons of public policy only three times.⁶² In 1984, Giorgio Gaja, editor of *International Commercial Arbitration: New York Convention*, listed 190 reported cases applying the New York Convention around the world, 43 of which were tried in the United States. Of those 43, only 6 dealt directly with the public policy defense in Article

56. *Id.* at 270.

57. See Nadelmann and Von Mehren, *Equivalences in Treaties in the Conflicts Field*, 15 AM. J. COMP. L. 195, 200 (1967).

58. See generally Haight, *supra* note 43.

59. Barry, *supra* note 50, at 840.

60. 2 P. Sanders, *INTERNATIONAL COMMERCIAL ARBITRATION* 323 (1959).

61. Haight, *supra* note 43, at 71.

62. Sanders, *supra* note 44, at 271.

V(2)(b) of the New York Convention.⁶³

In 1972 the United States Supreme Court took a step towards embracing international arbitration as a means of dispute resolution. The decision that prompted recent developments did not involve an arbitration agreement, but rather, its first cousin, the choice of forum clause.⁶⁴ In *Bremen v. Zapata Offshore Co.* the litigants had agreed to submit any disputes arising out of a towage contract to litigation in London.⁶⁵ Despite this agreement, when damage occurred during towing, Zapata refused to submit to the English court's jurisdiction claiming *forum non conveniens*.⁶⁶ While the claim was not made that the forum was against public policy, the Court examined the lower court's remarks concerning public policy.⁶⁷

The court of appeals had suggested that enforcement would be contrary to public policy as it was in the case of *Bisso v. Inland Waterways Corp.*, 349 U.S. 85 (1955).⁶⁸ *Bisso* concerned a purely domestic towage contract containing an exculpatory clause that attempted to disclaim any liability resulting from the tugboat's own negligence.⁶⁹ In *Bremen* the Supreme Court rejected the idea that domestic public policy mandates that the choice of forum clause in an international agreement is unenforceable.⁷⁰ The Court distinguished *Bremen* and *Bisso* on the grounds that *Bremen* concerned an "international agreement."⁷¹ The Court went on to describe the essential purpose of international arbitration clauses, stating "The elimination of all such uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade."⁷² Although the public policy defense was not raised, and thus an interpretation of public policy

63. IX Y.B. Comm. Arb. 389, International Council for Commercial Arbitration (1984).

64. Smedresman, *Conflict of Laws in International Commercial Arbitration: A Survey of Recent Developments*, 7 CAL. W. INT'L L.J. 263, 329 (1977).

65. 407 U.S. 1 (1972).

66. *Id.* at 4.

67. *Id.* at 15.

68. *Id.* at 15.

69. The court held in *Bisso* that an exculpatory clause in the towing contract which attempted to place the liability of the towing company's own negligence on the other party was unenforceable because of public policy. *Bisso* at 90.

70. 407 U.S. at 15. The Court allowed the litigation to continue in London realizing that the English court would probably allow the exculpatory clauses in the contract which relieved Bremen from liability from its own negligence.

71. 407 U.S. at 16.

72. *Id.* at 13.

was not needed, the Supreme Court evidenced its attitude that "We cannot have trade and commerce in world markets and international waters exclusively on our terms . . ." ⁷³

The first American court called on to directly interpret the extent of the public policy defense was the United States Court of Appeals for the Second Circuit in *Parsons & Whittemore Overseas Co. v. Societe Generale De L'Industrie Du Papier* [RAKTA]. ⁷⁴ The court saw no definite guidelines from the legislative history of the Convention nor any convincing arguments from commentators. The court drew inferences from the Convention as a whole, and relying on the "general pro-enforcement bias" of the Convention, recognized only a "narrow reading of the public policy defense." ⁷⁵ The court emphasized that the defense was not to be used to protect "parochial" national interests but rather that by acceding to the Convention, the United States was subscribing to a supranational interest. This, coupled with fears of retaliatory use of the public policy exception by foreign courts led the Second Circuit to conclude that enforcement of arbitral awards can be denied only when enforcement would "violate the forum state's most basic notions of morality and justice." ⁷⁶ Although the court articulated arguments espousing limited use of the public policy defense, the standard of "morality and justice" offers little exact guidance.

The Supreme Court continued to distinguish between domestic public policy and the narrower concept of international public policy in *Scherk v. Albert Culver Co.* ⁷⁷ The question in *Scherk* was whether to allow the arbitration of a securities issue in an international contract despite federal statutes prohibiting the waiver of a right to trial in a securities case. ⁷⁸ In a 5-4 decision, the Supreme Court allowed the arbitration in reversing the court of appeals and its reliance on *Wilko v. Swan*. ⁷⁹ The *Wilko* decision denied enforcement of arbitration on grounds that the issue concerned the domes-

73. *Id.* at 9.

74. 508 F.2d 969 (2d Cir. 1974); accord *Antco Shipping Co., Ltd. v. Sidermar S.P.A.*, 417 F. Supp. 207 (S.D.N.Y. 1976).

75. 508 F.2d at 973.

76. *Id.* at 974.

77. 417 U.S. 506 (1974), *reh'g denied*, 419 U.S. 885 (1974).

78. Section 14 of the Securities Act of 1933, 15 U.S.C. § 77n and Section 29 of the Securities Exchange Act of 1934, 15 U.S.C. 78cc(a) both state that any stipulation requiring a person to waive provisions of the relevant sections shall be void. The relevant sections are 15 U.S.C. § 77v of the 1933 Act and 15 U.S.C. 78aa of the 1934 Act which allow the plaintiff to bring suit in the proper court.

79. 346 U.S. 427 (1953).

tic sale of securities and that public policy was against arbitration on questions of securities transactions as evidence by the Securities Act of 1933.⁸⁰ The Court in *Scherk* distinguished *Wilko* by noting that *Scherk*, although still a securities matter, dealt with a contract that was a "truly international agreement."⁸¹ Thus, the Court felt more aligned with the policy articulated in *Bremen*. The Court followed much the same reasoning found in *Bremen* by commenting on the importance of arbitration clauses to achieve certainty in international transactions, as well as the need to avoid parochial refusals of enforcement which may incite the parties to destructive tactical jockeying.⁸² This tactical jockeying may occur if parties begin to forum shop on the international level to find a country that will issue an order to enjoin litigation wherever it may have started to allow the arbitration to continue. These tactics are destructive in that they undermine the certainty of international litigation and thus trade agreements. The "internationalism" of the agreement seemed to be determinative.⁸³ The Court also looked closely at the goal of the New York Convention and felt United States ratification of the Convention was strongly persuasive evidence of congressional policy consistent with its decision.⁸⁴

Yet, there still emerged no clear guidelines from *Scherk* except possibly the necessity that the contract be truly "international" for the public policy exception to prevail.⁸⁵

One year later in *Fotochrome Inc. v. Copal Co. Ltd.*,⁸⁶ the United States Court of Appeals for the Second Circuit again followed the reasoning of *Bremen* and enforced an arbitration clause in an international contract when the court probably would not have enforced the agreement had the arbitration clause been in a purely domestic context. In *Fotochrome* the court reversed the bankruptcy court's stay of arbitration proceedings. The court noted that there was no reference to the type of public policy required for non-recognition of foreign arbitral awards. The court also pointed out that the legislative history offered no concrete guidelines.⁸⁷ The

80. *Id.* at 431.

81. *Scherk*, 417 U.S. 506, 515 (1974).

82. *Id.* at 516, 517.

83. *Id.* at 519.

84. *Id.* at 520, n.15.

85. Although the court concedes that "situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in *Wilko* would meaningfully apply." *Id.* at 517, n.11.

86. 517 F.2d 512 (2d Cir. 1975).

87. *Id.* at 516.

court stressed the strong policy in favor of international recognition and adopted the *Parsons & Whittemore Overseas Co.*⁸⁸ guideline of "most basic notions of morality and justice."⁸⁹

In 1983 the United States Court of Appeals for the First Circuit grappled with the guidelines and precedent of *Scherk, Bremen*, and the New York Convention itself only to refuse recognition and enforcement of an arbitration clause in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*⁹⁰ Although in *Mitsubishi* the court actually ruled that antitrust issues are not a subject matter capable of settlement by arbitration under Article V, the court also discussed the public policy issues of Article V(2)(b) in the New York Convention.⁹¹

The court distinguished *Scherk* and identified the principle that courts cannot refuse to enforce arbitration because of "parochial" reasons. However, the court argued that the strong American policy against arbitrating antitrust issues⁹² is well known, and therefore, not a parochial reason.⁹³ The court attacked the premise that international agreements may be protected from United States laws by arbitration agreements. The court felt it would be too easy for American businesses to achieve immunity from antitrust laws by the device of a sham agreement with a foreign entity.⁹⁴

While the resulting impact of *Mitsubishi* on the vagaries of judicial guidelines as to the V(2)(b) public policy exception may be unclear and indirect, it does appear that two conflicting points have been made by the First Circuit. First, the international flavor of a contract may not ensure enforcement of an arbitration clause. Second, that allegedly "parochial" policies may not be enough to override arbitration.

In the end, the court uses a balancing test derived from *Scherk* in which the court must "weigh the private party's interest in the arbitration of international contract disputes against the public's interest in the preservation of economic order in the United States."⁹⁵ The court is not to accept the private interest in arbitration at the expense of public policy if to do so is unreasonable.⁹⁶

88. *Parsons & Whittemore Overseas Co. v. Societe Generale De L'Industrie Du Papier (RAKTA)*, 508 F.2d 969 (2d Cir. 1974).

89. *Fotochrome Inc. v. Copal Co. Ltd.*, 517 F.2d 512, 513 (2d Cir. 1975).

90. 723 F.2d 155 (1983).

91. *Id.* at 164 & 166.

92. "Anti-trust laws being the Magna Carta of free Enterprise" *Id.* at 163.

93. *Id.* at 167.

94. *Id.* at 163.

95. *Id.* at 168.

96. *Id.* at 168.

Thus, the final guideline for the First Circuit becomes the internal, infernal, standard of "reasonableness."

The aforementioned cases illustrate that the courts' articulated standards permit the public policy defense when enforcement of the arbitration award would "violate basic notions of morality and justice."⁹⁷ However, allegedly parochial reasons⁹⁸ cannot deny enforcement of an arbitration clause in a truly international agreement.⁹⁹ Obviously, the standards articulated by the courts are vague and subjective. References to these standards do little to clarify a particular case. However, the reasons the courts have construed the defense so narrowly are: a fear of retaliatory nonenforcement,¹⁰⁰ acceptance of the need for arbitration in international trade,¹⁰¹ a recognition that the United States has no right to claim international supremacy,¹⁰² and a view that the Convention indicates acceptance of narrow interpretation of the public policy defense.¹⁰³

It appears from *Scherk* and *Mitsubishi* that the courts apply a basic balancing test of public versus private interests. The path to close the public policy loophole has been illuminated by the previously discussed commentators and court decisions which argue there is a general pro-enforcement attitude evidenced by the United States accession to the New York Convention. Completion of the path may best be achieved by arguing the positive effect of arbitration clauses on international trade in general. Certainly under the current problematic guidelines of the public policy defense there is an opportunity for the defense to be rejected in any specific case. Indeed, as one commentator, John Junker, argues, "the courts have given the public policy defense so narrow a construction that it now must be characterized as a defense without meaningful definition."¹⁰⁴ Junker concludes that since the courts have emasculated the public policy defense, "then the use of international commercial arbitration may mean a significant sacrifice of American governmental or statutory protections."¹⁰⁵

97. See note 58 and 70 *supra*.

98. See note 57 *supra*.

99. See note 64 *supra*.

100. See note 74 *supra*.

101. See note 54 *supra*.

102. See note 55 *supra*.

103. See note 57 *supra*.

104. Note, *supra* note 42, at 245.

105. *Id.* at 246.

Mitsubishi, however, negates the argument that the defense is meaningless. The court in *Mitsubishi* spoke favorably of the public policy defense, yet the court articulated this same fear of losing the sanctions and protection of United States laws.¹⁰⁶

Junker concludes that the loss of the protections of American law will result in a crippling deterrent to agreements to employ arbitration as opposed to the contribution which the courts and the framers intended.¹⁰⁷ Although Junker's note may appear well reasoned, it seems to emphasize the "protection" of United States statutes, while *Mitsubishi* seems to be pointing out that one cannot blindly hope to escape the "protection" of United States laws with an arbitration clause. Junker also seems to ignore the role of an arbitrator in avoiding fundamental unfairness between the parties.¹⁰⁸ This protection against unfairness is much the same goal as the protection of the United States statutes.

Junker also overlooks the ability of the parties to foresee and allocate the risks of the agreement under the freedom to contract. Indeed, the rationale for enforcing arbitration clauses rests largely on what the Supreme Court has called "ancient concepts of freedom of contract" in allowing international businesses to agree beforehand to a neutral forum in case of dispute.¹⁰⁹ Freedom to contract, however, does have its limits.¹¹⁰ Professor Sterk argues that despite the apparent opacity of the term "public policy," its use by the courts can be explained by a common rationale.¹¹¹ He states:

Public policy should be invoked to prevent arbitration when at issue is a legislative expression or basic case law principle designed for some purpose other than to foster justice between the parties in dispute. Conversely, when the legal principles involved in a particular dispute are designed primarily to promote justice between the parties, there is little reason to prohibit arbitration.¹¹²

106. *Mitsubishi*, 723 F.2d 155, 163 (1st Cir. 1983).

107. Note, *supra* note 42, at 247.

108. DOMKE COMM. ARBITRATION § 25:01 (Rev. Ed).

109. *Bremen*, 407 U.S. 1, 11 (1975).

110. Contracts otherwise thought to be a valid offer and acceptance with adequate consideration may be voided by the defense of: incapacity, mistake, misrepresentation, duress, undue influence, unconscionability, and public policy. A contract cannot override these limitations on the contract. An arbitrator may also take the presence of these factors into consideration.

111. Sterk, *supra* note 53, at 483.

112. *Id.* at 483.

III. SUGGESTED STANDARDS FOR THE ACCEPTANCE OF THE PUBLIC POLICY DEFENSE

This author would like to suggest the injection of Professor Sterk's criteria into the previously articulated standards of the proper use of the public policy exception in order to clarify the proper extent of the exception. It seems clear enough that there is no purpose in overriding an arbitration agreement (by not enforcing it) when the arbitrator is attempting to resolve a dispute if the impact of that dispute is entirely between the parties to the arbitration. The concern that a party is waiving the protection of United States statutes is diminished by the arbitrator's judgement of fairness, and one's freedom to allocate risks with the contract.

However, in some areas legal rules are designed to promote interests that are beyond the fair resolution of the issue between the two parties. In these areas of dispute, such as antitrust, public policy should be used to override the arbitration agreement because the arbitration will not necessarily consider or protect the interests of the public at large or the interests that third parties may have in the dispute.¹¹³ The court in *Mitsubishi* recognizes this reasoning by distinguishing *Scherk* as an allowable arbitration because the securities laws are designed to protect a fairly small special interest group while antitrust laws, the issue in *Mitsubishi*, protect the general public.¹¹⁴

The New York Convention of 1958 has been hailed as an important step forward,¹¹⁵ a considerable success,¹¹⁶ or even the beginning of a new "Esperanto" of international arbitration law.¹¹⁷ The public policy clause, however, is a loophole of concern for those who wish to expand, narrow, or simply define the clause. A clear definition would promote the goal of alternative dispute resolution by increasing the simplicity and certainty of arbitration in the context of international trade. While the courts have been reluctant to issue definite guidelines on the use of the public policy defense, they should be encouraged to articulate a clear standard of an acceptable public policy defense based on the reasoning that they have developed. The freedom to contract between two parties can be upheld, and the essence of the Convention supported, by a

113. *Id.* at 492.

114. *Mitsubishi*, 723 F.2d 155, 168 (1st Cir. 1983).

115. Sanders, *supra* note 60, at 323.

116. Sanders, *supra* note 44, at 269.

117. Aksen, *supra* note 14, at 26.

balancing of all the factors in denying the public policy defense and enforcing arbitration awards in cases concerning international contracts containing arbitration clauses fairly bargained for which substantially affect only the interests of the contracting parties.

The public policy defense should prevail to deny enforcement of an arbitral award only when that award violates the forum's most basic notions of morality and justice, and also disregards any significantly detrimental impact on the public's interests.

